

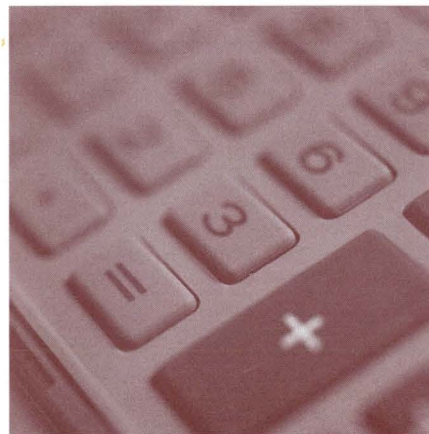
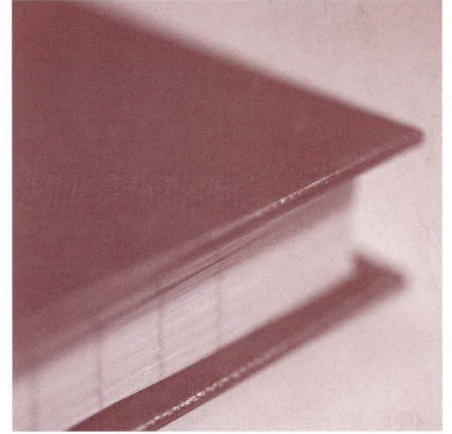
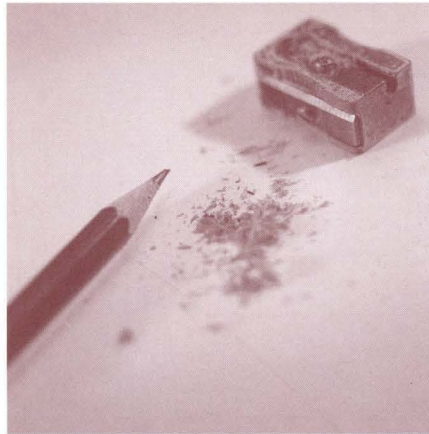
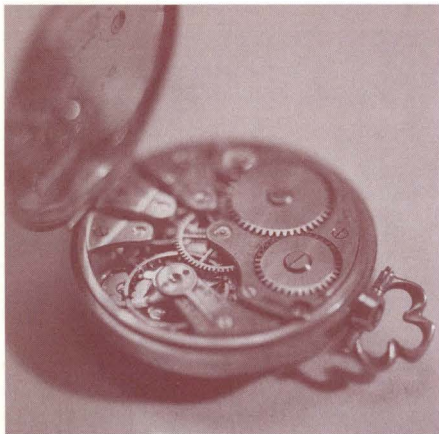
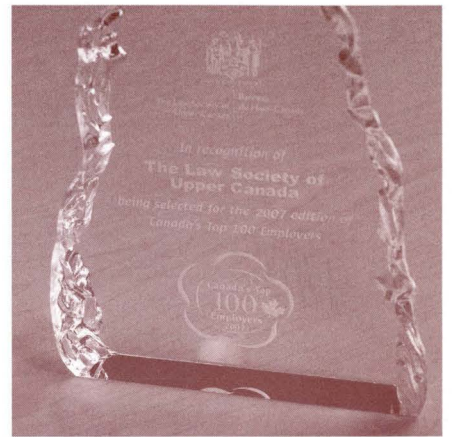
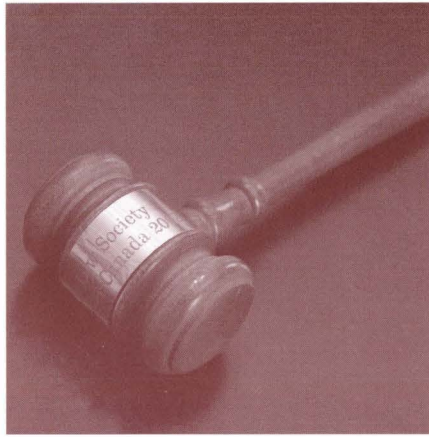
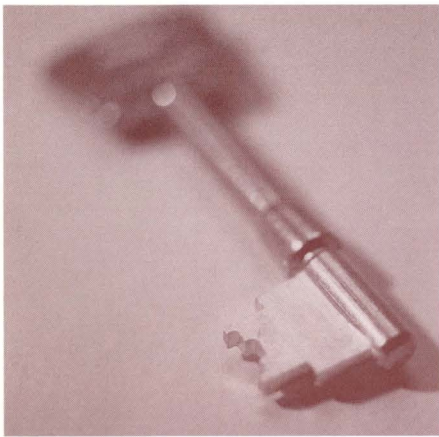
2006 Annual Report

Financial Statements



The Law Society of
Upper Canada

Barreau
du Haut-Canada





The Law Society of
Upper Canada | Barreau
du Haut-Canada

Annual General Meeting, 2007

Wednesday, May 9, 2007

at 5:15 p.m.

Osgoode Hall, Toronto

ORDER OF BUSINESS

- Minutes of the previous Annual General Meeting
- Report of the work of the Society and the committees of Convocation
- Presentation of the audited financial statements
- Matters of professional interest that are related to the work of the Society

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The Law Society of
Upper Canada | Barreau
du Haut-Canada

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The Law Society of
Upper Canada

Barreau
du Haut-Canada

GENERAL FUND

Management Discussion and Analysis

The Law Society of Upper Canada ("the Society") General Fund is composed of a number of funds included in these financial statements. The Unrestricted Fund is the Society's operating fund, representing the bulk of its revenues and expenses. There are a number of special purpose funds restricted by Convocation. These are the Capital Allocation, Invested in Capital Assets, County Libraries, Special Projects, Repayable Allowance, Endowment and the Working Capital Reserve funds. The Society's annual membership fee is based on the financial requirements of the restricted and unrestricted funds.

Separate financial statements are prepared for the Lawyers Fund for Client Compensation, LibraryCo Inc. and the Combined Errors and Omissions Insurance Fund.

BALANCE SHEET

Cash and short-term investments

Cash and short-term investments have decreased by approximately \$1.8 million from \$15.9 million at the end of 2005 to \$14.1 million at December 31, 2006. The short-term investments include government backed securities and money market instruments issued by major Canadian banks.

Portfolio investments

Portfolio, or long-term investments, increased slightly to \$10.8 million from \$10.5 million and comprise North American equities (20%) and Canadian bonds (80%). The portfolio is managed in compliance with the General Fund's investment policy. Fixed income investments include a diversified mix of government, provincial and corporate bonds with an investment rating of "BBB" or better. Equity investments include a diversified mix of equities listed on the major U.S. and Canadian stock exchanges. At December 31 2006, the market value was \$255,000 more than the book value of the portfolio.

Capital assets

The decrease in capital assets from \$23.1 million to \$22.9 million reflects the completion of the Osgoode Hall north wing renovation project in February 2006 and the commencement of related amortization. Total expenditures on the north wing renovation were \$9.7 million.

The Ottawa property, with a carrying value of \$2.1 million, classified as "capital assets held for resale" in 2005, was sold in May 2006 for \$2.2 million.

Current liabilities

Accounts payable and accrued liabilities have decreased by \$3.3 million to \$5.9 million as a result of the payment of holdbacks on the north wing renovation project, the payment of a litigation provision and the reversal, into income, of a statute barred accrued liability.

Deferred revenue of \$5.5 million, representing 2007 membership fees received in 2006, has decreased from \$7.2 million.

Unclaimed trust funds

Unclaimed trust funds continue to increase, reaching \$1.4 million in 2006 (2005: \$1.3 million). These are trust monies turned over to the Society by members who are unable to locate or identify the clients to whom the monies are owed. By statute, the Society administers these funds, in perpetuity, with the net income from the funds transferred to the Law Foundation of Ontario annually. The Society is reimbursed for expenses associated with the administration of unclaimed trusts to a limit of the annual income earned on funds held.

STATEMENT OF REVENUES AND EXPENSES

The Society's General Fund has generated an unrestricted surplus of \$1.2 million as a result of operations for 2006 (2005: \$367,000).

Total revenues for the General Fund increased by \$2 million from \$57.2 million in 2005 to \$59.2 million in 2006. Net expenses increased slightly from \$57.8 million to \$58.6 million.

*REVENUES**Membership Fees*

Membership fees increased by \$3 million in 2006 attributable to approximately 750 more members and a \$68 per member fee increase.

Professional Development and Competence

The major components of professional development and competence ("PD&C") revenues are the licensing process and post-call education programs. PD&C revenues declined by \$2.3 million over 2005 as a result of a reduction in the tuition fee from \$4,400 for the bar admission course to \$2,600 for the new licensing process.

Investment Income

Investment income comprises interest earned on fixed income investments, dividends earned on equities and net capital gains realized on the disposition of bonds or equities. Also included in investment income is a \$3 million (2005: \$2.5 million) transfer of investment income from the Errors and Omissions Insurance Fund leading to the \$617,000 increase in total investment income to \$4.1 million. The annual return on the short-term portfolio was 4% for 2006, up from 2.9% in 2005, consistent with increased short-term interest rates. The return on bonds was 4.4% (2.1% in 2005). The total rate of return on the long-term portfolio was 6.5% (2005: 3%).

Other revenues

Other revenues were consistent with 2005 and include a variety of items such as lawyer referral service fees, Ontario Reports royalties, catering revenues, litigation and enforcement cost recoveries, charges for fee payment plans and other miscellaneous revenues including the reversal of provisions deemed no longer necessary.

EXPENSES

Total net expenses of \$58.6 million represent a nominal increase from \$57.8 million in 2005, although the biggest individual departmental change was the \$1.4 million decline in PD&C expenses after the transition from the bar admission course to the streamlined licensing process. As anticipated, this decrease was offset by direct regulatory operating expenses increasing with the rising costs associated with mortgage fraud.



*General Fund**Professional Development and Competence*

Professional Development and Competence expenses decreased because of reductions in exam administration, materials production and instruction expenses as the streamlined licensing process transitioned from the bar admission course. Continuing Legal Education expenses were static year-on-year.

Professional Regulation

Direct Professional Regulation expenses increased from \$12 million in 2005 to \$13.3 million in 2006. The regulatory division is in the midst of a number of large and complex mortgage fraud investigations necessitating additional employees in 2006 and an increase in outside counsel and expert witness costs.

Administrative

Administrative expenses of the Finance, Information Systems and Human Resources departments increased to \$7.1 million from \$6.3 million in 2005. The increase was primarily attributable to increased work on information systems necessary to maintain the Society's key operating systems.

Other expenses

Other expenses include benchers related disbursements, payments to the Federation of Law Societies and CANLII, insurance and audit fees, catering costs, payments to CDLPA, OLAP, Pro Bono Law Ontario, the Advocates' Society, severance payments and other miscellaneous expenses of the Society. Total other expenses of \$5.3 million have decreased from \$6.1 million in 2005 primarily because of year-on-year differences in severance costs and provisions for uncollectable accounts receivable.

Amortization

Amortization of \$2.4 million has increased over 2005 with the amortization of the renovation costs of the north wing over a ten-year period.

STATEMENT OF CHANGES IN FUND BALANCES

Capital Allocation Fund

The Capital Allocation Fund is the funding source for approved capital projects. The fund is replenished on an annual basis by the \$75 portion of member fees (unchanged from 2005) dedicated to capital funding. The Fund was the recipient of the \$2.2 million in proceeds from the sale of the Ottawa property.

Invested in Capital Assets Fund

Expenditures capitalized and reported as capital assets are maintained in the Invested in Capital Assets Fund, which has decreased to \$22.9 million with the sale of the Ottawa property and amortization for the year.

County Libraries Fund

In 2006, the \$6.8 million in County Library expenses show a small increase from previous years. The Society levies, collects and remits funds for county library purposes to LibraryCo Inc. on a basis determined when the annual budgets are approved.

Repayable Allowance Fund

In 2006, the Law Society's Repayable Allowance program provided \$94,000 to 28 students (2005: \$213,000 to 66 students).

Endowment Fund

The Society administers the J. Shirley Denison Endowment Fund, established to provide relief and assistance to members, students and former members. During the year, \$53,000 was paid to 15 eligible applicants (2005:\$57,000 to 14 eligible applicants).

Special Projects Fund

The Special Projects Fund is maintained to ensure that financing is available for ongoing special projects that have been approved but not completed in the fiscal year budgeted. The 2006 year-end balance is \$128,000, primarily representing remaining funding for the Task Force on the Independence of the Bar and the Rule of Law and the survey of the impact of law school tuition fee increases.

Working Capital Reserve

The Working Capital Reserve of \$7.9 million is unchanged since being set in 2002 at a level equivalent to two months of the Society's operating expenses. Since that time operating expenses have increased so that the reserve now represents 1.6 months of operating expenses. The Working Capital Reserve will generate the cash required to pay the expenses of the recently approved paralegal start-up budget. The paralegal start-up budget projects a deficit of \$1.5 million to be recovered from paralegals in future years. The Society's cash reserves will be replenished with this repayment by paralegals.

General Fund

*General Fund***Auditors' Report**

TO THE MEMBERS OF THE LAW SOCIETY OF UPPER CANADA,

We have audited the balance sheet of THE LAW SOCIETY OF UPPER CANADA – GENERAL FUND as at December 31, 2006 and the statements of revenues and expenses, changes in fund balances and cash flows for the year then ended. These financial statements are the responsibility of the Society's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the General Fund as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Ontario
February 16, 2007

Balance Sheet

Stated in thousands of dollars

As at December 31

	2006	2005
ASSETS		
Current Assets		
Cash and short-term investments	14,134	15,933
Accounts receivable (note 3)	1,646	2,088
Prepaid expenses	196	291
Total current assets	15,976	18,312
Portfolio investments (note 4)	10,822	10,512
Capital assets held for resale (note 5)	–	2,085
Capital assets (note 6)	22,880	23,061
Total Assets	49,678	53,970
LIABILITIES AND FUND BALANCES		
Current Liabilities		
Accounts payable and accrued liabilities	5,995	9,297
Deferred revenue	5,518	7,226
Total current liabilities	11,513	16,523
Unclaimed trust funds (note 7)	1,416	1,266
Total Liabilities	12,929	17,789
FUND BALANCES		
Unrestricted fund	1,915	1,046
Restricted funds		
Capital allocation	3,546	1,622
Invested in capital assets	22,880	25,146
County libraries	–	(53)
Repayable allowance	52	46
Endowment	253	294
Special projects	128	105
Working capital reserve	7,975	7,975
Total Fund Balances	36,749	36,181
Total Liabilities and Fund Balances	49,678	53,970

See accompanying notes

On behalf of Convocation

Gavin MacKenzie

Treasurer

W. O. Miller

Chair of Finance and Audit Committee

GENERAL FUND

Statement of Revenues and Expenses

*Stated in thousands of dollars**Year ended December 31*

	2006			2005		
	Unrestricted Fund	Restricted Funds	Total	Unrestricted Fund	Restricted Funds	Total
REVENUES						
Membership fees	31,086	9,007	40,093	28,659	8,390	37,049
Professional development and competence	9,345	—	9,345	11,625	—	11,625
Investment income	4,145	12	4,157	3,531	9	3,540
Other (note 9)	4,813	805	5,618	4,886	119	5,005
Total revenues	49,389	9,824	59,213	48,701	8,518	57,219
EXPENSES						
Professional development and competence	14,696	—	14,696	16,050	—	16,050
Professional regulation	13,283	—	13,283	11,990	—	11,990
Administrative	7,135	—	7,135	6,324	—	6,324
Other (note 10)	5,333	—	5,333	6,084	—	6,084
Client service centre	3,947	—	3,947	3,860	—	3,860
Facilities	3,180	—	3,180	3,277	—	3,277
Policy and legal services	2,051	—	2,051	2,009	—	2,009
Communications	1,117	—	1,117	1,342	—	1,342
Equity	795	—	795	750	—	750
Tribunals	660	—	660	579	—	579
Capital allocation fund	—	1,104	1,104	—	802	802
Invested in capital assets — amortization	—	2,416	2,416	—	1,899	1,899
County libraries fund	—	6,801	6,801	—	6,240	6,240
Repayable allowance fund	—	94	94	—	213	213
Endowment	—	53	53	—	183	183
Special projects fund	—	2	2	—	114	114
Total expenses	52,197	10,470	62,667	52,265	9,451	61,716
Less: Expenses allocated to Lawyers Fund for Client Compensation (note 1)	(4,022)	—	(4,022)	(3,931)	—	(3,931)
Net expenses	48,175	10,470	58,645	48,334	9,451	57,785
Surplus (deficit)	1,214	(646)	568	367	(933)	(566)

See accompanying notes

GENERAL FUND

Statement of Changes in Fund Balances

Stated in thousands of dollars

Year ended December 31

	2006										2005
	RESTRICTED FUNDS										
	Unrestricted Fund	Capital Allocation	Invested in Capital Assets	County Libraries	Repayable Allowance	Endowment	Special Projects	Working Capital Reserve	Total Restricted Funds	Total	Total
Fund balances, beginning of year	1,046	1,622	25,146	(53)	46	294	105	7,975	35,135	36,181	36,747
Revenues	49,389	3,009	91	6,707	—	12	5	—	9,824	59,213	57,219
Expenses	48,175	1,104	2,416	6,801	94	53	2	—	10,470	58,645	57,785
Surplus (deficit)	1,214	1,905	(2,325)	(94)	(94)	(41)	3	—	(646)	568	(566)
Interfund transfers											
Asset disposal	—	2,176	(2,176)	—	—	—	—	—	—	—	—
Asset capitalization	(78)	(2,157)	2,235	—	—	—	—	—	78	—	—
Transfer to county libraries fund	(147)	—	—	147	—	—	—	—	147	—	—
Transfer to repayable allowance fund	(100)	—	—	—	100	—	—	—	100	—	—
Transfer to special projects fund	(20)	—	—	—	—	—	20	—	20	—	—
Total interfund transfers	(345)	19	59	147	100	—	20	—	345	—	—
Fund balances, end of year	1,915	3,546	22,880	—	52	253	128	7,975	34,834	36,749	36,181

See accompanying notes

GENERAL FUND

Statement of Cash Flows

*Stated in thousands of dollars**Year ended December 31*

	2006	2005
OPERATING ACTIVITIES		
General fund surplus (deficit)	568	(566)
Items not affecting cash:		
Amortization of capital assets	2,416	1,899
Gain on sale of capital assets held for resale	(91)	—
Other operating sources (uses) of cash:		
Accounts receivable	442	(263)
Prepaid expenses	95	(136)
Accounts payable and accrued liabilities	(3,302)	1,606
Deferred revenue	(1,708)	260
Fund contribution – unclaimed trusts	150	238
Cash from operating activities	(1,430)	3,038
INVESTING ACTIVITIES		
Portfolio investments (net)	(310)	(403)
Proceeds on sale of capital assets held for resale	2,176	—
Capital asset additions	(2,235)	(8,924)
Cash used in investing activities	(369)	(9,327)
Net decrease in cash and short-term investments during the year	(1,799)	(6,289)
Cash and short-term investments, beginning of year	15,933	22,222
Cash and short-term investments, end of year	14,134	15,933

See accompanying notes

Notes to Financial Statements

*Stated in whole dollars except where indicated
For the year ended December 31, 2006*

1. Description of Fund

The Law Society of Upper Canada (the "Society") was founded in 1797 and incorporated in 1822 with the enactment of the *Law Society Act*. The Society exists to govern the legal profession in the public interest. This is achieved by ensuring that the people of Ontario are served by lawyers who meet high standards of learning, competence and professional conduct and by upholding the independence, integrity and honour of the legal profession, for the purpose of advancing the cause of justice and the rule of law. The governing body of the Society, which is known as Convocation, carries out this mandate.

The *Law Society Act* was amended by the *Access to Justice Act* in October 2006, which will come into full effect on May 1, 2007 to legislate the regulation of paralegals by the Society. The legislation resulted in the formation of the Paralegal Standing Committee. The legislation expands the function of the Society to ensure that:

- (a) All persons who practise law or provide legal services in Ontario meet standards of learning, professional competence and professional conduct that are appropriate for the legal services they provide.
- (b) The standards of learning, professional competence and professional conduct for the provision of a particular legal service in a particular area of law apply equally to persons who practise law and persons who provide legal services in Ontario.

The Society is not subject to income or capital taxes because it is a not-for-profit corporation. These financial statements represent the financial position and operations of the Law Society of Upper Canada – General Fund, which includes certain internally restricted funds, and do not purport to represent all assets and liabilities under the control of the Society.

Separate financial statements have been prepared for the following related entities, which have not been consolidated into the General Fund statements:

Lawyers Fund for Client Compensation

The Society maintains the Lawyers Fund for Client Compensation ("Compensation Fund") pursuant to section 51 of the *Law Society Act* to relieve or mitigate loss sustained by any person in consequence of dishonesty on the part of any member in connection with such member's law practice or in connection with any trust of which the member was or is a trustee. Members' annual fees and investment income finance the Compensation Fund. The Compensation Fund reports fees collected by the General Fund as revenues. The Compensation Fund reimburses the General Fund for certain administrative expenses, spot audit expense and a portion of the costs of operating the investigation and discipline functions of the Society. In 2006 these amounted to \$4,022,000 (2005 – \$3,931,000).

Errors & Omissions Insurance Fund and Lawyers' Professional Indemnity Company

The Society provides professional liability insurance to the legal profession through the Errors and Omissions Insurance Fund ("E&O Fund") and the Lawyers' Professional Indemnity Company ("LAWPRO"). The E&O Fund was originally set up in the Society's accounts to record insurance claims and expenses and related levies and their investment. LAWPRO took over underwriting the program commencing in 1990. LAWPRO, a wholly owned subsidiary of the Society, was incorporated in 1990 and is licensed to provide lawyer's professional liability and title insurance. On an annual basis the E&O Fund provides the General Fund with income derived from its surplus earnings. This income, reported as Investment Income of the General Fund, amounted in 2006 to \$3,000,000 (2005 – \$2,500,000). LAWPRO paid \$238,000 (2005 – \$102,000) primarily for shared information systems, governance costs and government relations services.

GENERAL FUND

LibraryCo Inc.

LibraryCo Inc., a wholly owned, not-for-profit subsidiary of the Society, was established to develop policies, procedures, guidelines and standards for the delivery of county law library services across Ontario and to administer funding on behalf of the Society. LibraryCo Inc. was incorporated under the Business Corporations Act of Ontario in 2001. The Corporation issued 100 voting Common Shares to the Society for \$100 and 100 Special Shares to the County and District Law President's Association for \$100. The holders of the Special Shares are entitled to elect one director.

The Society levies and collects funds for County and District Law Library purposes and transfers these funds to LibraryCo Inc. Convocation internally restricts these funds for use by county law libraries to carry out their annual operations and any special projects approved by Convocation.

Law Society Foundation

The Law Society Foundation ("LSF"), a registered charity, was incorporated by Letters Patent in 1962.

The objectives of the LSF are to foster, encourage and promote legal education in Ontario, provide financial assistance to law students in Ontario, restore and preserve land and buildings of historical significance to Canada's legal heritage, receive gifts of muniments and legal memorabilia of interest and significance to Canada's legal heritage, maintain a collection of gifts of books and other written material for use by educational institutions in Canada, receive donations and maintain a fund for the relief of poverty by providing meals to persons in need. The Society provides facilities, administration, accounting, security and certain other services at no cost to the LSF.

The Law Foundation of Ontario

The Law Foundation of Ontario ("LFO"), a corporation without share capital established in 1974, was created to receive interest accruing on monies held in lawyers' mixed trust accounts and to establish and maintain a fund to be used for the purposes of legal education and legal research, legal aid and the establishment, maintenance and operation of law libraries. During 2006, the LFO contributed \$944,000 to the General Fund of the Society (2005 – \$1,447,000) for the operation of the Licensing Process / Bar Admission Course and \$76,000 (2005 – \$100,000) for legal heritage programs.

2. Significant Accounting Policies

Basis of presentation

The financial statements have been prepared in accordance with the accounting standards for not-for-profit organizations published by the Canadian Institute of Chartered Accountants using the restricted fund method of reporting revenues.

Description of funds

The *Unrestricted Fund* accounts for the Society's program delivery and administrative activities. This fund reports unrestricted resources.

Restricted Funds

The *Capital Allocation Fund* is maintained to provide a source of funds for the acquisition and maintenance of the Society's capital assets. These include buildings and major equipment including computers. Amounts of assets capitalized, according to the Society's capital asset policy, are transferred to the Invested in Capital Assets Fund. Expenditures not capitalized are expended in the Capital Allocation Fund. At December 31, 2006 the balance was \$3,546,000 (2005 – \$1,622,000).

The *Invested in Capital Assets Fund* records transactions related to the Society's capital assets, specifically acquisitions, amortization and disposals. At December 31, 2006 the balance was \$22,880,000 (2005 – \$25,146,000).

The *County Libraries Fund* records transactions related to the Society's support of county law libraries. The fund accumulates levies raised by the Society for county library purposes. The Society remits amounts to LibraryCo Inc. on a predetermined basis as approved by Convocation. In recent years the funds remitted have nominally exceeded

GENERAL FUND

the funds collected, and in 2006 an amount of \$147,000 was transferred from the Unrestricted Fund to finance the accumulated deficit. At December 31, 2006 the fund balance was nil (2005 deficit – \$53,000).

The *Repayable Allowance Fund* provides students with funding for tuition and living expenses and is based on a student's ability to repay the grant within a specified period of time following the student's non-participation in the Licensing Process / Bar Admission Course. At December 31, 2006, the balance was \$52,000 (2005 – \$46,000).

The *Endowment Fund* is the J. Shirley Denison Fund, established to provide relief and assistance to members and former members who find themselves in difficult financial circumstances. Contributions for endowments are recognised as revenue in the Endowment Fund. At December 31, 2006, the Endowment Fund balance was \$253,000 (2005 – \$294,000).

The *Special Projects Fund* is maintained to ensure that financing is available for ongoing special projects. The balance at December 31, 2006 was \$128,000 (2005 – \$105,000).

The *Working Capital Reserve* is maintained to ensure adequate cash reserves for the continuous financing of the Society's operations. This fund balance is sufficient to provide for the Society's operating expenses for up to two months. At December 31, 2006 the balance was \$7,975,000 (2005 – \$7,975,000).

Cash and short-term investments

Cash and short-term investments are amounts on deposit and invested in short-term (less than one year) investment vehicles according to the Society's investment policy. They are subject to insignificant risk of a change in value. Investment income, except income earned on resources held for endowment, is retained in and reported by the Unrestricted Fund.

Portfolio investments

Portfolio investments are recorded at cost, net of amortization of premiums and discounts. Investments consist of a diversified portfolio of government bonds, corporate bonds and Canadian and U.S. equities, according to the Society's investment policy. Only if a loss in the value of an investment is other than a temporary decline is the investment written down to recognize the loss.

Capital assets

Assets are capitalized and subject to amortization when they are determined to have a minimum useful life of three years and an acquisition cost of \$10,000 for equipment, furniture and computer equipment, \$25,000 for computer software and \$25,000 for building improvements. Capital assets are presented at cost net of accumulated amortization. For purposes of calculating the first year's amortization, all capital assets are deemed to be acquired, put into service, or completed on July 1st. Amortization is charged to expenses on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings	30 years
Building improvements	10 years
Furniture, equipment and computer hardware and software	3 to 5 years

Revenue recognition

Membership fees are recognized in the year to which they relate if the amount can be reasonably estimated and collection is reasonably assured. Accordingly, fees for the next fiscal year received prior to December 31 have been deferred and are recognized as revenue in the next year.

Professional development and competence, investment and other revenues are recognized when receivable if the amount can be reasonably estimated and collection is reasonably assured.

Collections

The Society owns a collection of legal research and reference material as well as a collection of portraits and sculptures. The cost of additions to the collections is expensed as incurred. No value is recorded in these financial statements for donated items.

GENERAL FUND

Volunteer services

The Law Society is governed by a board of directors known as benchers, forty of whom are elected lawyers and eight of whom are appointed by the provincial government. Under the *Access to Justice Act*, two paralegals have also been appointed as benchers by the provincial government. The Province remunerates their appointed benchers. Elected and ex-officio benchers are only eligible for remuneration after contributing 26 days of voluntary time. The work of the Society is also dependent on other voluntary services by members of the profession. No value has been included in these financial statements for gratuitous services.

Financial instruments

The estimated fair values of short-term investments, accounts receivable, prepaid expenses, accounts payable, accrued liabilities and deferred revenue approximate their carrying amounts in the financial statements due to the relatively short period to maturity of these instruments.

Measurement uncertainty

The preparation of the financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingencies at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Accounts Receivable

Included in accounts receivable are certain related parties amounts as follows:

	2006	2005
The Law Foundation of Ontario	293,000	543,000
LibraryCo Inc.	16,000	—
Lawyers' Professional Indemnity Company	14,000	92,000
Lawyers Fund for Client Compensation	—	332,000
The Law Society Foundation	—	26,000

4. Portfolio Investments

(\$000's)

	2006		2005	
	Book Value	Market Value	Book Value	Market Value
Debt Securities	8,936	8,888	8,423	8,316
Common Shares	1,886	2,189	2,089	2,081
	10,822	11,077	10,512	10,397

5. Capital Assets Held For Resale

The land and building owned in Ottawa were placed on the market for sale in July 2005, and sold in May 2006. They were classified as capital assets held for resale at December 31, 2005, shown at carrying value.

GENERAL FUND

6. Capital Assets

(\$000's)

	2006			2005
	Cost	Accumulated Amortization	Net	Net
Land and buildings	25,395	17,216	8,179	8,730
Building improvements	17,475	4,168	13,307	4,411
Building improvements under construction	—	—	—	8,560
Furniture, equipment and computer hardware and software	5,446	4,052	1,394	1,360
	48,316	25,436	22,880	23,061

In 2004 construction commenced on the renovation of Osgoode Hall's north wing. Renovations were completed in 2006 at a total cost of \$9,710,000. Expenditures relating to this renovation were initially categorized as building improvements under construction and are now included as building improvements.

7. Unclaimed Trust Funds

Section 59.6 of the *Law Society Act* permits a member who has held money in trust for or on account of a person for a period of at least two years to apply in accordance with the by-laws for permission to pay the money to the Society. Money paid to the Society is held in trust in perpetuity for the purpose of satisfying the claims of the persons who are entitled to the capital amount. Subject to certain provisions in the Act enabling the Society to recover its expenses associated with maintaining these funds, net income from the money held in trust shall be paid to the Law Foundation of Ontario. Unclaimed money held in trust amounts to \$1,416,000 (2005 – \$1,266,000).

8. Other Trust Funds

The Society administers client funds for members under voluntary or court-ordered trusteeships. These funds and matching liabilities are not reflected on the Balance Sheet. Money paid to the Society is held in trust until it is repaid to the clients or transferred to the Unclaimed Trust Funds. At December 31, 2006 total funds held in trust amount to \$1,168,000 (2005 – \$2,269,000).

9. Other Revenue

Included in other revenue is income from the *Ontario Reports*, catering, the Lawyer Referral Service, specialist certification and other miscellaneous revenues.

10. Other Expenses

Included in other expenses are payments to the Federation of Law Societies, County and District Law Presidents' Association, insurance, professional fees, termination payments, catering, other corporate expenses and governance related disbursements. The total remuneration of elected and ex-officio benchers during the year was \$159,000 (2005 – \$134,000). The Treasurers' honoraria for the year was \$97,000 (2005 – \$103,000). The total value of bencher expenses reimbursed was \$489,000 (2005 – \$509,000).

11. Pension Plan

The Society maintains a defined contribution plan for all eligible employees of the Society. Law Society employees can choose matching employee and employer contributions between 1% and 6% of annual earnings, with the exception of designated employees for whom the Society contributes 12% of annual earnings, up to the maximum deduction allowed by the Canada Revenue Agency. The Society's General Fund pension expense in 2006 amounted to \$ 1,356,000 (2005 – \$1, 287,000).

GENERAL FUND

12. Commitments

The Society is committed to monthly lease payments for property under leases having various terms up to April 2010. Aggregate minimum monthly payments to the expiry of the leases are as follows:

Year	\$000's
2007	535
2008	558
2009	575
2010	194
Total	1,862

13. Contingent Liabilities

A number of claims or potential claims are pending against the Society. It is not possible for the Society to predict with any certainty the outcomes of such claims or potential claims. Management is of the opinion that based on the information presently available, it is unlikely that any liability, to the extent not covered by insurance or inclusion in the financial statements, would be material to the Society's financial position.

14. Guarantees

In the normal course of business the Society has entered into agreements that meet the definition of a guarantee, including indemnities in favour of third parties, such as confidentiality agreements, engagement letters with advisors and consultants, outsourcing agreements, leasing contracts, information technology agreements and service agreements. Under the terms of these agreements, the Society agrees to indemnify the counterparties for various items including, but not limited to, all liabilities, loss, suits, and damages arising during, on or after the term of the agreement. The maximum amount of any potential future payment cannot be reasonably estimated.

The Society has also provided indemnification to all directors and officers of the Society. Under s.9 of the *Law Society Act*:

"No action or other proceedings for damages shall be instituted against the Treasurer or any benchers, official of the Society or person appointed in Convocation for any act done in good faith in the performance or intended performance of any duty or in the exercise or in the intended exercise of any power under this Act, a regulation, a by-law or a rule of practice and procedure, or for any neglect or default in the performance or exercise in good faith of any such duty or power."

Notwithstanding s.9, the Society has also purchased errors and omissions insurance for past and present officers, employees, committee members, benchers, agents and volunteers acting on behalf of the Society, its subsidiaries and affiliates, to mitigate the cost of any potential suit or action.

No estimate of the maximum exposure under these indemnifications can be made and historically the Society has not made any significant payments under such or similar indemnification agreements. Therefore no amount has been accrued in the financial statements with respect to these agreements.

15. Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform to the current year's financial statement presentation.

Management Discussion and Analysis



The Law Society of
Upper Canada | Barreau
du Haut-Canada

The Lawyers Fund for Client Compensation ("the Compensation Fund") is maintained by the Law Society, in accordance with the *Law Society Act*, to relieve or mitigate loss sustained by any person in consequence of dishonesty on the part of any member in connection with such member's practice or in connection with any trust of which the member is or was a trustee. The Compensation Fund is financed by member's annual fees, recoveries and investment income.

The financial position of the Compensation Fund remains strong. Results for the year identify a surplus of \$1.4 million compared to a deficit of \$1.6 million for 2005. This change is attributable to the downward revision of the Reserve for Unpaid Grants of \$1.4 million and recoveries in 2006 of just over \$1 million.

The fund balance at the end of December 2006 is \$19.4 million up from \$17.9 million at the same time last year. In five of the last six years the fund balance has increased.

BALANCE SHEET

Cash and short-term investments

The Compensation Fund's short-term investments, which together with cash total \$4.8 million, are invested in banker's acceptances and Government of Canada T-bills.

Portfolio investments

Portfolio, or long-term investments (\$23.7 million compared to \$22.6 million in 2005), are made up of fixed income (84%) and North American equities (16%). The portfolio is managed in compliance with the Compensation Fund's investment policy. Fixed income investments comprise a diversified mix of government, provincial and corporate bonds with an investment rating of "BBB" or better. Equity investments comprise a diversified mix of equities listed on the major United States and Canadian stock exchanges. At December 31, 2006 the market value was \$1.2 million more than the book value of the portfolio.

Reserve for unpaid grants

Based upon the actuarial valuation of the grant reserve, the reserve for unpaid grants has decreased by \$1.4 million to \$9.2 million.



Lawyers Fund for Client Compensation

STATEMENT OF REVENUES AND EXPENSES AND CHANGE IN FUND BALANCE

Revenues

Membership fees

Membership fees increased from \$5.9 million in 2005 to \$6.1 million in 2006 due to membership numbers increasing by approximately 750.

Investment income

Investment income comprises interest earned on fixed income investments, dividends earned on equities and net capital gains realized on the disposition of bonds or equities. Investment income has decreased from \$1.6 million in 2005 to \$1.3 million in 2006 as a result of a decrease in net realized gains in the current year. The annual return on the short-term portfolio was 4% for 2006, up from 2.6% in 2005, consistent with increased short-term interest rates. The return on bonds was 4.4% (8% in 2005). The total rate of return on the long-term portfolio, including unrealized gains, was 6.2% (2005: 7.2%).

Expenses

Net grants expense

Grants paid during the year increased from \$3.2 million in 2005 to \$4 million. These incurred payments, combined with favourable developments on previously reserved amounts and low claims in the current year, means the Reserve for Unpaid Grants has decreased by \$1.4 million during 2006.

Recoveries of \$1.1 million (2005: \$308,000) were unusually significant in 2006. Recoveries do not follow any pattern and the current receipts are sourced from court orders on trust accounts by the Society's Trustee Services Department, the sale of some property and restitution orders.

Other

The Compensation Fund's 2006 other expenses were generally stable compared to 2005. The share of investigations and discipline and also administrative expenses are allocated from the Law Society's General Fund, employing a formula as part of the Society's full cost allocation.

Auditors' Report

TO THE MEMBERS OF THE LAW SOCIETY OF UPPER CANADA,

We have audited the balance sheet of THE LAW SOCIETY OF UPPER CANADA – LAWYERS FUND FOR CLIENT COMPENSATION as at December 31, 2006 and the statements of revenues and expenses and change in fund balance and of cash flows for the year then ended. These financial statements are the responsibility of the Society's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Ontario
February 16, 2007

*Lawyers Fund for
Client Compensation*



LAWYERS FUND FOR CLIENT COMPENSATION

Balance Sheet

*Stated in thousands of dollars**As at December 31*

	2006	2005
ASSETS		
Current Assets		
Cash and short-term investments	4,772	6,232
Interest and other receivables	172	166
Total Current Assets	4,944	6,398
Portfolio investments (<i>note 4</i>)	23,676	22,571
Total Assets	28,620	28,969
LIABILITIES AND FUND BALANCE		
Accounts payable and accrued liabilities	19	356
Reserve for unpaid grants	9,243	10,678
Total Liabilities	9,262	11,034
Fund Balance	19,358	17,935
Total Liabilities and Fund Balance	28,620	28,969

See accompanying notes

On behalf of Convocation

Gavin MacKenzie

Treasurer

W. O. Miller

Chair of Finance and Audit Committee

Statement of Revenues and Expenses and Change in Fund Balance

*Stated in thousands of dollars**Year ended December 31*

	2006	2005
REVENUES		
Membership fees	6,125	5,971
Investment income	1,346	1,574
Total revenues	7,471	7,545
EXPENSES		
Grants paid	4,001	3,272
(Decrease) increase in reserve for unpaid grants	(1,435)	1,638
Recoveries	(1,149)	(308)
Net grants expense	1,417	4,602
Spot audit	2,034	1,957
Share of investigation and discipline	1,092	1,051
Administrative	1,054	1,085
Salaries and benefits	451	446
Total expenses	6,048	9,141
Surplus (deficit)	1,423	(1,596)
Fund balance, beginning of year	17,935	19,531
Fund balance, end of year	19,358	17,935

See accompanying notes

LAWYERS FUND FOR CLIENT COMPENSATION

Statement of Cash Flows

*Stated in thousands of dollars**Year ended December 31*

	2006	2005
OPERATING ACTIVITIES		
Surplus (deficit)	1,423	(1,596)
Item not affecting cash:		
(Decrease) increase of reserve for unpaid grants	(1,435)	1,638
Other operating uses of cash:		
Accounts receivable	(6)	(49)
Accounts payable and accrued liabilities	(337)	(112)
Total operating activities	(355)	(119)
INVESTING ACTIVITY		
Portfolio investments (net)	(1,105)	(1,337)
Net decrease in cash and short-term investments during the year	(1,460)	(1,456)
Cash and short-term investments, beginning of year	6,232	7,688
Cash and short-term investments, end of year	4,772	6,232

See accompanying notes

Notes to Financial Statements

Stated in whole dollars except where indicated

For the year ended December 31, 2006

1. Description of Fund

The Lawyers Fund for Client Compensation (the “Fund”) is maintained by The Law Society of Upper Canada (the “Society”) pursuant to section 51 of the *Law Society Act* to relieve or mitigate loss sustained by any person in consequence of dishonesty on the part of any member in connection with such member’s law practice or in connection with any trust of which the member was or is a trustee. The Fund is financed by members’ annual fees and investment income.

The *Law Society Act* was amended by the *Access to Justice Act* in October 2006, which will come into full effect on May 1, 2007 to legislate the regulation of paralegals by the Society. The legislation resulted in the formation of the Paralegal Standing Committee. The legislation expands the function of the Society to ensure that:

- (a) All persons who practise law or provide legal services in Ontario meet standards of learning, professional competence and professional conduct that are appropriate for the legal services they provide.
- (b) The standards of learning, professional competence and professional conduct for the provision of a particular legal service in a particular area of law apply equally to persons who practise law and persons who provide legal services in Ontario.

The Fund is not subject to income or capital taxes because it is a fund of the Society, a not-for-profit corporation.

The Fund reimburses the Society’s General Fund for certain administrative expenses, spot audit expenses and a portion of the costs of operating the investigation and discipline functions of the Society. The charges for the year amount to \$4,022,000 (2005 – \$3,931,000).

2. Significant Accounting Policies

Basis of presentation

The financial statements have been prepared in accordance with the accounting standards for not-for-profit organizations published by the Canadian Institute of Chartered Accountants, using the restricted fund method of reporting revenues. The Fund accounts for the program delivery, administration and payment of grants from the Fund. The Fund is restricted in use by the *Law Society Act*.

Cash and short-term investments

Cash and short-term investments are amounts on deposit and invested in short-term (less than one year) investment vehicles according to the Society’s investment policy and are subject to an insignificant risk of change in value.

Portfolio investments

Portfolio investments are recorded at cost, net of amortization of premiums and discounts. Investments consist of a diversified portfolio of government bonds, corporate bonds and Canadian and U.S. equities, according to the Society’s investment policy. Only if a loss in the value of an investment is other than a temporary decline is the investment written down to recognize the loss.

LAWYERS FUND FOR CLIENT COMPENSATION

Revenue recognition

Membership fees are recognized in the year to which they relate if the amount can be reasonably estimated and collection is reasonably assured. Investment income is recognized when receivable if the amount can be reasonably estimated.

Grants

Pursuant to section 51(5) of the *Law Society Act*, the payment of grants from the Fund is at the discretion of Convocation, the governing body of the Society. Grants paid are subject to a \$100,000 limit per applicant. A reserve for unpaid grants is recorded as a liability on the balance sheet. This reserve represents an estimate of the present value of grants to be paid for unprocessed claims and the associated administrative costs, as determined by an actuary. The related net grants expense represents grant payments during the year plus the current year experience gain/loss of the reserve for unpaid grants, net of recoveries.

Financial instruments

The estimated fair values of short-term investments, interest and other receivables and accounts payable and accrued liabilities approximate their carrying amounts in the financial statements due to the relatively short period to maturity of these instruments.

3. Measurement Uncertainty

The valuation of unpaid grants anticipates the combined outcomes of events that are yet to occur. There is uncertainty inherent in any such estimation and therefore a limitation upon the accuracy of these valuations. Future loss emergence may deviate from these estimates. No provision has been made for otherwise unforeseen changes to the legal or economic environment in which claims are settled, nor for causes of loss which are not already reflected in the historical data. Management believes that the techniques employed and assumptions made are appropriate and the conclusions reached are reasonable given the information currently available. Estimates of unpaid grants are reviewed at least annually by an actuary and, as adjustments become necessary, they are reflected in current operations.

4. Portfolio Investments

(\$000's)	2006		2005	
	Book Value	Market Value	Book Value	Market Value
Debt Securities	19,891	20,152	18,426	18,964
Common Shares	3,785	4,690	4,145	4,378
	23,676	24,842	22,571	23,342

Management Discussion and Analysis



The Law Society of
Upper Canada | Barreau
du Haut-Canada

COMBINED BALANCE SHEET

Investments

Investment assets, inclusive of cash and cash equivalents, increased by \$29.6 million to \$436.1 million at December 31, 2006. The increase in investments represents assets held to meet insurance claims obligations, with the balance representing surplus funds generated in the year. Investment assets are managed in accordance with investment policy in a diversified, high quality portfolio of fixed income securities (86%) and equities (14%).

Provision for Unpaid Claims and Adjustment Expenses and Reinsurers' Share thereof

The provision for unpaid claims represents the amount required to satisfy all of the Errors and Omission Insurance Fund's obligations to claimants prior to recoveries from reinsurers. This has increased by \$5.6 million in 2006. Reinsurance recoveries have declined by \$13.7 million and accordingly the net increase in the provision is \$19.3 million at December 31, 2006. This increase is primarily attributable to the impact of changes in reinsurance arrangements made since 2002 as the percentage ceded under quota share reinsurance in respect of the Ontario mandatory professional liability insurance program declined from 57% in 1995 to nil effective January 1, 2003.

Surplus

The surplus has increased by \$8.2 million, the excess of revenue over expenses for the year.

COMBINED STATEMENT OF REVENUE AND EXPENSES AND SURPLUS

In 2006, the Errors and Omissions Insurance Fund generated an excess of revenue over expenses of \$8.2 million, an increase of \$.3 million from 2005. Total expenses increased by \$8.0 million in 2006 to \$103.3 million and revenues increased by \$8.3 million to \$111.6 million.



*Errors and
Omissions Insurance
Fund*

Members' Levies

Members' levies, representing insurance premiums under the Society's mandatory Professional Liability Insurance Program, amounted to \$76.6 million, an \$8.6 million increase compared to 2005. The base annual levy for the Ontario professional liability program was increased by \$75 per member to \$2,700 in 2006. Insurance premiums also included a transfer of \$0.2 million to the Premium Stabilization Fund, triggered under the provisions of the Society's contract for the insurance program.

Investment Income

The Combined Fund generated \$20.9 million of investment income, a decrease of \$1.8 million from the prior year, which includes net capital gains of \$3.4 million (2005 – \$6.6 million) realized on the disposition of assets. At December 31, 2006, the market value of the portfolio exceeded book value by almost \$17.6 million (2005 – \$13.5 million).

Net Claims and Adjustment Expenses

Incurred claims of \$71.9 million are \$3.2 million higher than the prior year. Favorable development of prior years' claims in the amount of \$12.3 million partly offset the higher claims incurred in respect of the current year as compared to 2005.

Reinsurance Premiums

Reinsurance arrangements and their costs are fairly consistent with the prior year: \$4.9 million in 2006 compared to \$4.6 million in 2005.

General Expenses

General expenses in 2006 are substantially as anticipated with the increase of \$2.2 million primarily attributable to the program's ongoing costs, including risk management initiatives.

Auditors' Report

TO THE MEMBERS OF THE LAW SOCIETY OF UPPER CANADA

We have audited the combined balance sheet of THE LAW SOCIETY OF UPPER CANADA – ERRORS AND OMISSIONS INSURANCE FUND as at December 31, 2006 and the combined statements of revenue and expenses and surplus and of cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these combined financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

Licensed Public Accountants

Toronto, Ontario

February 9, 2007

*Errors and
Omissions Insurance
Fund*



*Errors and
Omissions Insurance
Fund*

Report of the Valuation Actuary

TO THE MEMBERS OF THE LAW SOCIETY OF UPPER CANADA

ROLE OF THE VALUATION ACTUARY

The valuation actuary is appointed by the Audit Committee of the Lawyers' Professional Indemnity Company in its capacity as manager of the Law Society of Upper Canada Errors and Omissions Insurance Fund. With respect to the preparation of these combined financial statements, the actuary is required to carry out a valuation of the claim liabilities and to report thereon to the Audit Committee, and through it to the membership of the Law Society. The valuation is carried out in accordance with accepted actuarial practice, and regulatory requirements. The scope of the valuation encompasses the claim liabilities, that is the provision for unpaid claims and adjustment expenses on claims incurred and reported as of December 31, 2006, the date of these combined financial statements.

In performing a valuation of the liabilities, which by their very nature are inherently variable, the actuary makes assumptions as to future rates of claims severity, inflation, reinsurance recoveries, expenses and other matters, taking into consideration the circumstances of the Errors and Omissions Insurance Fund, the Lawyers' Professional Indemnity Company and the nature of the insurance coverage being offered. The valuation is necessarily based on estimates; consequently the final values may vary significantly from those estimates. The actuary also makes use of management information provided by the Law Society and the Lawyers' Professional Indemnity Company, and uses the work of the auditor with respect to the verification of the underlying data used in the valuation.

VALUATION ACTUARY'S REPORT

I have valued the claim liabilities arising on the errors and omissions insurance coverage arranged by the Law Society of Upper Canada for its Errors and Omissions Insurance Fund combined balance sheet as at December 31, 2006, and their changes in its combined statement of revenue and expenses and surplus for the year then ended, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of the claim liabilities makes appropriate provision for all such obligations, and the financial statements fairly present the results of the valuation.



Toronto, Ontario
February 9, 2007

Brian G. Pelly
Fellow, Canadian Institute of Actuaries

Combined Balance Sheet

Stated in thousands of dollars

As at December 31

	2006	2005
ASSETS		
Cash and cash equivalents	2,765	2,648
Investments (note 3)	433,345	403,832
Investment income due and accrued	3,026	3,634
Accounts receivable	10,216	10,980
Reinsurers' share of provision for:		
Unpaid claims and adjustment expenses (note 5)	66,187	79,860
Other assets	343	307
Capital assets (note 4)	432	589
Future income taxes (note 10)	7,750	6,177
Total assets	524,064	508,027
LIABILITIES AND SURPLUS		
Provision for unpaid claims and adjustment expenses (note 5)	331,958	326,348
Premium Stabilization Fund (note 7)	32,701	32,529
Accounts payable and accrued liabilities	9,401	7,387
	374,060	366,264
Surplus (note 11)	150,004	141,763
Total liabilities and surplus	524,064	508,027

See accompanying notes

On behalf of Convocation:

Gavin MacKenzie

Treasurer

[Signature]

Chair of Finance and Audit Committee

ERRORS AND OMISSIONS INSURANCE FUND

Combined Statement of Revenue and Expenses and Surplus

*Stated in thousands of dollars**Year ended December 31*

	2006	2005
REVENUE		
Insurance premiums, mandatory insurance program (<i>notes 2 and 6</i>)	76,633	68,012
Other insurance premiums	10,338	9,376
Reinsurance commissions	3,727	3,205
Investment and other income	20,879	22,679
Total revenue	111,577	103,272
EXPENSES		
Net claims and adjustment expenses (<i>note 5</i>)	71,946	68,728
Reinsurance premiums	4,886	4,632
General expenses	15,756	13,571
Transfer to the Society's General Fund (<i>note 8</i>)	3,000	2,500
Premium taxes	2,610	2,325
Income taxes (<i>note 10</i>)	5,138	3,557
Total expenses	103,336	95,313
Excess of revenue over expenses	8,241	7,959
Surplus, beginning of year	141,763	133,804
Surplus, end of year	150,004	141,763

See accompanying notes

Combined Statement of Cash Flows

Stated in thousands of dollars

Year ended December 31

	2006	2005
OPERATING ACTIVITIES		
Excess of revenue over expense	8,241	7,959
Items not affecting cash:		
Future income taxes	(1,573)	(682)
Amortization of capital assets	311	469
Realized gains	(3,413)	(6,549)
Amortization of premiums and discounts on bonds	(1,438)	(447)
	2,128	750
Changes in non-cash balances:		
Investment income due and accrued	608	(1,347)
Accounts receivable	764	8,139
Provision for unpaid claims and adjustment expenses	5,610	4,306
Reinsurers' share of provision for unpaid claims & adjustment expenses	13,673	18,046
Premium Stabilization Fund	172	7,027
Other assets	(36)	79
Accounts payable and accrued liabilities	2,014	(418)
Net cash inflow from operating activities	24,933	36,582
INVESTING ACTIVITIES		
Purchase of capital assets	(154)	(329)
Purchases of investments	(336,514)	(217,997)
Proceeds of sale of investments	311,852	152,103
Net cash outflow from investing activities	(24,816)	(66,223)
Increase/(decrease) in cash and cash equivalents during the year	117	(29,641)
Cash and cash equivalents, beginning of year	2,648	32,289
Cash and cash equivalents, end of year	2,765	2,648
Cash and cash equivalents at the end of year consists of:		
Cash	2,493	1,504
Cash equivalents	272	1,144
	2,765	2,648

See accompanying notes

Notes to Combined Financial Statements

Stated in whole dollars except where indicated

As at December 31, 2006

1. The Insurance Program and its Risk Retention and Reinsurance Structure

The combined financial statements of the Errors and Omissions Insurance Fund ("the Combined Fund") primarily account for the net results of the Professional Liability Insurance Program of the Law Society of Upper Canada ("the Society"). The program requires practising members to pay levies that contribute towards premiums to fund the anticipated costs of professional liability claims made in each annual policy period. Indemnification of members is subject to the terms of the insurance policy, including financial limits per claim and aggregate limits per member in each policy period.

These financial statements combine the results of operations, financial positions and cash flows of:

- the Errors and Omissions Insurance Fund of the Society ("the Fund"), originally set up in the Society's accounts to record insurance claims and expenses and related levies and their investments; and
- Lawyers' Professional Indemnity Company ("LAWPRO" or "the Company"), a wholly owned subsidiary of the Society that was incorporated in 1990 as an insurance company and is licensed to provide professional liability insurance to lawyers and title insurance.

The risk retention and reinsurance structures employed through these two entities are described in the following paragraphs.

Prior to July 1, 1990, the Society's Errors and Omissions Insurance Program was underwritten by various insurance carriers subject to a policy deductible. LAWPRO took over the underwriting of the program commencing July 1, 1990. The Society maintained financial responsibility for the policy deductible through to December 31, 1994. The policy deductible was a combination of a group deductible and the individual member deductibles. For the periods noted below, the combined policy deductibles were as follows:

July 1989 to June 1990	\$ 250,000	per occurrence
July 1990 to December 1991	\$ 200,000	per occurrence
January 1992 to December 1994	\$ 250,000	per occurrence

The Society was not able to arrange Stop Loss reinsurance on its group deductible after the policy period ending June 1989. As a result, the full financial risk of the deductible rested with the Society, from July of 1989 through the policy period ended December 1994.

LAWPRO also had a net retention above the policy's group deductible as follows:

- July 1, 1990 to December 31, 1991: LAWPRO is liable for \$50,000 of all individual losses in excess of \$200,000;
- January 1, 1992 to December 31, 1992: LAWPRO is liable for an aggregate of \$2,500,000 from individual losses incurred in excess of \$250,000 plus a further 10% of all losses above \$250,000 once the initial \$2,500,000 limit has been reached; and
- January 1, 1993 to December 31, 1994: LAWPRO is liable in each policy year for an aggregate of \$4,000,000 if incurred losses are above or exceed \$250,000 plus a further 10% of all losses in excess of \$250,000 once the initial \$4,000,000 limit has been reached.

It was decided, effective January 1, 1995, to eliminate the self-insured group deductible. Commencing January 1, 1995, 100% of the risk over the individual member deductibles is insured within LAWPRO. LAWPRO in turn reinsures a portion of its risk retention with third party Canadian licensed reinsurers.

The annual policy limits for each of the years effective January 1, 1995 through December 31, 2006 are \$1 million per claim and \$2 million in aggregate per member.

2. Significant Accounting Policies

These combined financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The most significant accounting policies are as follows:

Insurance premiums and other premium related balances

The insurance policy in respect of the Society and its members under the Society's mandatory professional liability insurance program is effective on a calendar year basis. In addition, members may opt for additional annual coverage under the Excess professional liability insurance policies offered by LAWPRO. Professional liability insurance premium income is earned on a pro rata basis over the term of coverage of the underlying insurance policies; generally one year, except for policies for retired lawyers, which have terms of up to five years. The portion of premiums related to the unexpired term of coverage at the balance sheet date is recorded as unearned premiums within accounts payable and accrued liabilities in the balance sheet.

Title insurance premiums are earned at the inception date of policies.

Premiums receivable are recorded under accounts receivable in the balance sheet, net of any required provision for doubtful amounts. Premiums received from insureds in advance of the effective date of the insurance policy are recorded under accounts payables and accrued liabilities in the balance sheet.

LAWPRO defers policy acquisition costs, primarily premium taxes on its written professional liability insurance premiums, to the extent these costs are considered recoverable. These costs are expensed on the same basis that the related premiums are earned. The method to determine recoverability of deferred policy acquisition costs takes into consideration future claims and adjustment expenses to be incurred as premiums are earned and anticipated investment income. Deferred policy acquisition costs are not material at year-end.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments with maturities of three months or less at the time of acquisition. The fair value of cash and cash equivalents approximates the amounts shown in the financial statements.

Investments

Investments in debt securities are carried at amortized cost with premiums and discounts on the par value of debt securities amortized on a straight-line basis over the term to maturity. Investments in common and preferred shares are carried at cost. Realized gains and losses on investments are calculated using the carrying value of securities sold.

Investment income includes interest and dividends earned, amortization of premiums and discounts on debt securities and realized gains and losses. Any loss in value of an investment, which is considered other than temporary in nature, is also recognized in income.

Capital assets

Capital assets of LAWPRO are carried at amortized cost. Amortization is charged to expense on a straight-line basis over the estimated useful lives of the assets as follows:

Leasehold improvements	Term of lease
Furniture and equipment	3 to 5 years
Computer equipment and software	1 to 3 years

Other income

Other income is miscellaneous income other than premium income or investment income and is recognized when it is earned.

ERRORS AND OMISSIONS INSURANCE FUND

*Claims related balances**a) Provision for unpaid claims and adjustment expenses*

The provision for unpaid claims and adjustment expenses is an estimate of the ultimate cost of all insurance claims not paid as at the balance sheet date and is determined using case-basis evaluations and an amount for the expected future development of claims incurred as at the balance sheet date. The provision takes into account the time value of money.

b) Deductibles

The professional liability insurance policy requires insureds to pay deductibles to the maximum extent of \$25,000 each on individual claims. Expected deductible recoveries on paid and unpaid claims are recognized net of any required provision for uncollectible accounts at the same time as the related claims liability.

Reinsurance

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers in the statement of income. Amounts relating to reinsurance in respect of the premiums and claims related balances in the balance sheet are recorded separately. Amounts recoverable from reinsurers are estimated and recognized in a manner consistent with the Fund's and LAWPRO's method of determining the related policy liability associated with the reinsurance policy.

Employee future benefits

LAWPRO maintains a defined contribution pension plan for its employees as well as a supplemental defined benefit pension plan for certain designated employees that provides benefits to those employees in excess of the benefits provided by LAWPRO's defined contribution pension plan. The benefit liability under the supplemental defined benefit pension plan is actuarially determined using the projected benefit method pro-rated on service and LAWPRO management's assumptions about discount rates, expected plan assets' performance, salary growth and retirement ages of employees. The discount rate is determined on the basis of market conditions at year end and other assumptions are based on long term expectations.

Adjustments for plan amendments are recognized fully into income in the year to which they relate. Changes in assumptions and actuarial gains and losses are recognized into income in the year following the actuarial valuation of the benefit liability to which they relate.

Income taxes

LAWPRO is subject to income taxes. It uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax basis of assets and liabilities, and are measured using the tax rates and laws that are expected to be in effect in the periods in which the future income tax assets or liabilities are expected to be settled or realized, where those tax rates and laws have been substantively enacted.

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates and changes in estimates are recorded in the year in which they are determined. The most significant assets and liabilities that require estimation in their determination are the provision for unpaid claims and adjustments and reinsurers' share thereof (*note 5*).

3. Investments

The Fund and LAWPRO hold a diversified portfolio consisting of equities and fixed income debt securities with investment grades of "BBB" or better.

ERRORS AND OMISSIONS INSURANCE FUND

Estimated fair values and unrealized gains and losses

The carrying value, estimated fair values and unrealized gains (losses) on investments at December 31 were as follows:

	2006 (\$000's)			
	Carrying Value	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Debt Securities	372,631	4,952	(737)	376,846
Common Shares	58,115	14,005	(805)	71,315
Preferred Shares	2,599	164	—	2,763
	433,345	19,121	(1,542)	450,924

	2005 (\$000's)			
	Carrying Value	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Debt Securities	355,933	7,715	(1,366)	362,282
Common Shares	45,300	9,376	(2,362)	52,314
Preferred Shares	2,599	129	—	2,728
	403,832	17,220	(3,728)	417,324

The effective yield on debt securities as at December 31, 2006 is 3.88% (2005: 4.14%).

The estimated fair values of debt securities, common and preferred shares are based on quoted market values.

Liquidity and interest rate risk

The maturity profile of debt securities as at December 31, 2006 is as follows:

(\$000's)	Within 1 Year	1 to 5 Years	Over 5 Years	Book Value
Debt Securities	25,213	194,129	153,289	372,631
Percent of total	7%	52%	41%	

The weighted average duration of debt securities at December 31, 2006 is 4.98 years (2005: 4.81 years). A portion of these debt securities are invested in a manner that substantially matches their duration to the expected duration over which the provision for claims and adjustment expenses is expected to be payable in future. Shares have no specific maturities.

4. Capital Assets

(\$000's)	2006			2005
	Cost	Accumulated Amortization	Carrying Value	Carrying Value
Furniture & Fixtures	1,174	(1,118)	56	70
Computer Equipment	2,439	(2,210)	229	274
Computer Software	2,246	(2,135)	111	176
Leasehold Improvement	935	(899)	36	69
Total	6,794	(6,362)	432	589

ERRORS AND OMISSIONS INSURANCE FUND

5. Provision for Unpaid Claims and Adjustment Expenses

The determination of the provision of unpaid claims and adjustment expenses is a complex process based on known facts, interpretations and judgment and is influenced by a variety of factors. Consequently, the measurement of the ultimate settlement costs of claims made to date that underlies the provision for unpaid claims and adjustment expenses and any related recoveries for reinsurance and deductibles, involves estimates and measurement uncertainty. The amounts are based on estimates of future trends in claims severity and other factors, which could vary as claims are settled.

Variability can be caused by several factors including the emergence of additional information on claims, changes in judicial interpretation and significant changes in severity or frequency of claims from historical trends. Ultimate costs incurred could vary from current estimates. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the methods of estimation that have been used will produce reasonable results given the current information. An actuary performs a valuation of claims liabilities at least annually. As adjustments to estimated claims liabilities become necessary, they are reflected in current operations.

To limit losses through the spreading of risks, the Fund and LAWPRO have ceded reinsurance to other insurers. In the event that a reinsurer is unable to meet obligations assumed under the respective reinsurance agreements, the Fund and LAWPRO are respectively liable for such amounts. LAWPRO has guidelines and a review process in place to ascertain the credit worthiness of the companies to which it cedes. Based on current information of the financial health of the reinsurers, no provision for doubtful debts has been made in the financial statements in respect of reinsurers.

Changes in provisions for unpaid claims and adjustment expenses recorded in the balance sheet comprise the following:

	2006 (\$000's)	2005 (\$000's)
Provision for unpaid claims and adjustment expenses – beginning of year – net	246,488	224,136
Change in provision for claims and adjustment expenses due to:		
Prior years' incurred claims	(12,309)	(9,391)
Current year's incurred claims	83,989	78,333
Net claims and adjustment expenses paid in relation to:		
Prior years	(45,742)	(40,722)
Current year	(6,921)	(5,796)
Impact of discounting	266	(72)
Provision for unpaid claims and adjustment expenses – end of year – net	265,771	246,488
Reinsurers' share of provisions for unpaid claims and adjustment expenses	66,187	79,860
Provision for unpaid claims and adjustment expenses – end of year – gross	331,958	326,348

As the provision for unpaid claims and adjustment expenses is recorded on a discounted basis and reflects the time value of money, its carrying value is expected to provide a reasonable basis for the determination of fair value. However, determination of fair value also requires the practical context of a buyer and seller, both of whom are willing and able to enter into an arm's length transaction.

6. Members' Levies, Mandatory Professional Liability Insurance Program

Members' levies relating to the mandatory professional liability insurance program contribute towards insurance premiums and comprise annual base levies of \$2,700 per member (2005 – \$2,625) and additional levies that are charged based on a member's claims history, status, and on the volume of specified categories of legal transactions. In 2006, additional levies contributing towards insurance premiums totalled \$24.1 million (2005 – \$25.0 million). Insurance premiums relating to the mandatory professional liability insurance program are presented net of any retrospective premium rating adjustment under the insurance policy between the Society and LAWPRO.

7. Premium Stabilization Fund

Revenues from transaction based levies are subject to change from year to year based on levels of legal transactions that, in part, reflect the changing economic climate. Revenues from transaction and claims history levies that are deemed to be in excess of required premium levels for the year, may be held for future insurance purposes in the Premium Stabilization Fund and applied to premiums under the insurance program in future years. Should a shortfall in these levies be experienced for the year, the resulting potential deficiency in premiums may be met by additional contributions from the Premium Stabilization Fund. There were no premium contributions from the Premium Stabilization Fund in 2006 and 2005.

Retrospective rating adjustments under the insurance policy between the Society and LAWPRO are accounted for as transfers between the Premium Stabilization Fund and premiums under the insurance program. As a result of the retrospective premium rating adjustments as of December 31, 2006, LAWPRO estimated a refund of \$0.2 million in premiums to the Premium Stabilization Fund (2005 – \$7.0 million).

8. Transfer to the Society's General Fund

A portion of the investment income earned by the Fund amounting of \$3.0 million (2005 – \$2.5 million) was determined to be in excess of the operating requirements of the insurance program and was transferred to the Society for general purposes.

9. Employee Future Benefits

LAWPRO has a defined contribution pension plan that is available to all its employees upon meeting the eligibility requirements. Each employee is required to contribute 4.5% of yearly maximum pensionable earnings and 6% in excess thereof, of an employee's annual base earnings. Under the plan, LAWPRO matches all employee contributions. LAWPRO made payments of \$421,000 in 2006 (2005 – \$385,000) and recorded pension expenses of \$424,000 (2005 – \$394,000).

LAWPRO also has a supplemental defined benefit pension plan. Funding for the supplemental plan commenced in 2005. Funding requirements are reviewed annually with an actuarial valuation for funding purposes effective as at December 31. The most recent actuarial valuation for funding purposes was at an effective date of December 31, 2005. For reporting purposes, all assets and liabilities associated with pension benefits have been measured using values as at December 31, 2006.

ERRORS AND OMISSIONS INSURANCE FUND

Defined benefit plan obligations

	2006 (\$000's)	2005 (\$000's)
Accrued benefit obligations		
Balance, beginning of year	1,705	1,264
Current service cost	134	110
Interest cost	94	79
Actuarial loss	139	252
Plan amendments	92	—
Balance, end of year	2,164	1,705

Defined benefit plan assets

	2006 (\$000's)	2005 (\$000's)
Fair value of plan assets		
Market value of plan assets – beginning of year	644	—
Actual return on plan assets, net of expenses	83	8
Employer contribution	833	636
Market value of plan assets – end of year	1,560	644

The defined benefit plan assets arise primarily from employer contributions that are originally allocated equally between deposits held with the Government of Canada and investments in the units of a balanced pooled fund, representing a portfolio mix of equities and debt securities.

Reconciliation of funded status surplus (deficit) of the benefit plans to the amounts recorded in the financial statements:

	2006 (\$000's)	2005 (\$000's)
Fair value of plan assets	1,560	644
Accrued benefit obligation	(2,164)	(1,705)
Funded status deficit	(604)	(1,061)
Unamortized net actuarial loss	45	259
Accrued benefit liability	(559)	(802)

The accrued benefit liability is included in accounts payable and accrued liabilities in the combined balance sheet.

ERRORS AND OMISSIONS INSURANCE FUND

Components of defined benefit costs recognized in the year:

	2006 (\$000's)	2005 (\$000's)
Current service cost	134	110
Interest cost	94	79
Actual return on assets	(83)	(8)
Actuarial losses	138	252
Plan amendment	92	—
Difference between actual and recognized actuarial losses	168	(252)
Difference between actual and expected return on assets	47	(8)
Defined benefit costs recognized in the statement of income	590	173

The significant assumptions used by LAWPRO are as follows (weighted average):

	2006	2005
Discount rate	5.00%	5.00%
Expected long term rate of return on plan assets	6.00%	6.00%
Rate of compensation increase	3.50%	3.50%

10. Income Taxes

LAWPRO's effective tax rate does not differ significantly from the applicable Canadian statutory income tax rate of 36.12%. LAWPRO's income tax expense has the following components:

	2006 (000's)	2005 (000's)
Current tax expense	6,711	4,239
Future tax (recovery)	(1,573)	(682)
Total income tax expense	5,138	3,557

LAWPRO's future income tax asset is the result of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The sources of these temporary differences and the tax effects for each year are as follows:

	2006 (\$000's)	2005 (\$000's)
Investments	2,832	1,376
Net provision for unpaid claims and adjustment expenses	4,599	4,371
Other	319	430
Total	7,750	6,177

During the year LAWPRO made payments of \$4.1 million to and received refunds of \$7,000 from tax authorities.

ERRORS AND OMISSIONS INSURANCE FUND

11. Surplus

The Surplus of the Combined Fund includes LAWPRO's shareholder's equity. At December 31, 2006 the shareholder's equity of LAWPRO, as reported in its financial statements, was \$119.0 million (2005 – \$109.6 million).

12. Operating Lease Rentals

LAWPRO is committed to monthly lease payments in respect of the premises from which it operates. The lease expires on January 31, 2008. Lease payment obligations are as follows:

2007	\$1,362,000
2008	\$ 114,000

13. Fair Value Disclosure

The fair value of the financial assets and liabilities other than investments (*note 3*) and the provision for unpaid claims and adjustment expenses (*note 5*) approximates their carrying value.

14. Comparative Information

Certain comparative amounts have been reclassified to conform to the current year's financial statement presentation.

LIBRARYCO INC.

Management Discussion and Analysis



The Law Society of
Upper Canada | Barreau
du Haut-Canada

LibraryCo Inc. is mandated to carry on the central management of the Ontario County and District Law Library system on a not-for-profit basis for the purpose of developing and enhancing skills for the “competent lawyer” in Ontario.

STATEMENT OF REVENUES AND EXPENSES

LibraryCo experienced a surplus of \$26,000 in 2006 (2005 - \$313,000 deficit).

Revenues

The \$7.8 million total revenues in 2006 consisted of grants of \$6.8 million (2005 – \$6.2 million) from the Law Society of Upper Canada and \$995,000 (2005 – \$984,000) from the Law Foundation of Ontario. The 2006 County Library levy collected by the Law Society was \$219 per member (2005 – \$206). The increase is primarily to meet rising costs passed on by legal publishers and to maintain the Reserve Fund.

The Law Foundation of Ontario grant finances the purchase of electronic products and the Virtual Reference Service – advoCHAT, which permits real time, on-line reference services, employing software based on “chat” technology.

Expenses

Expenses required for the operation of the 48 County and District Law Libraries made up \$7.4 million of the \$7.8 million total expenses (2005 – \$7.1 million out of a total of \$7.5 million). These expenses were primarily for collections – traditional and electronic, advoCHAT, personnel and operations. Apart from increases in legal publishing costs, expenses increased due to staffing changes needed in order to meet established standards. LibraryCo continues to balance the demand for electronic and other materials from the various libraries and to provide education in the use of these materials.

In 2006, \$409,000 (2005 – \$413,000) was spent on head office operations, the Roving Law Librarian, travel to libraries, professional fees and administration of the library system.

BALANCE SHEET

There were no significant changes in balance sheet values during the year. The Reserve Fund of \$1.1 million (2005 – \$1.07 million) is restricted for Country and District Law Library purposes as approved by the Board of Directors.



LibraryCo Inc.

Auditors' Report

TO THE SHAREHOLDERS OF LIBRARYCO INC.:

We have audited the balance sheet of LIBRARYCO INC. as at December 31, 2006 and the statements of revenue and expenses, changes in fund balances and cash flows for the year then ended. These financial statements are the responsibility of the organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Organization as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Ontario
January 19, 2007

Balance Sheet

Stated in dollars

As at December 31

	2006	2005
CURRENT ASSETS		
Cash and short-term investments	1,087,262	1,110,103
Prepaid expenses	15,144	14,464
Goods and Services Tax receivable	8,200	4,525
Due from Law Foundation of Ontario	39,677	–
	1,150,283	1,129,092
CAPITAL ASSETS (note 3)	7,897	11,324
Total Assets	1,158,180	1,140,416
LIABILITIES, SHARE CAPITAL AND FUND BALANCES		
Accounts payable and accrued liabilities	49,229	57,800
SHARE CAPITAL AND FUND BALANCES		
Share capital (note 4)	200	200
General fund	3,933	430
Invested in capital assets fund	7,897	11,324
Reserve fund	1,096,921	1,070,662
Total Share Capital and Fund Balances	1,108,951	1,082,616
Total Liabilities, Share Capital and Fund Balances	1,158,180	1,140,416

See accompanying notes

On behalf of the Board of Directors



Chair – Board of Directors



Chair – Finance Committee

LIBRARYCO INC.

Statement of Revenues and Expenses

*Stated in dollars**For the year ended December 31*

	2006	2005
REVENUES		
Law Society of Upper Canada grant	6,801,232	6,240,000
Law Foundation of Ontario grant	995,401	984,395
Interest income	26,259	16,345
Total revenues	7,822,892	7,240,740
EXPENSES		
Head office/administration		
Salaries and benefits	215,148	209,977
Office and occupancy	65,754	74,777
Professional fees	66,907	80,471
Other (note 5)	61,203	48,080
Total head office/administration expenses	409,012	413,305
County and District Law Libraries – centralized purchases		
Electronic products and services	1,650,269	1,433,816
Insurance and group benefits	266,297	257,657
Other (note 6)	178,070	181,057
Virtual Reference Service	145,401	134,396
	2,240,037	2,006,926
County and District Law Libraries – grants (note 7)	5,060,518	5,060,087
Capital and special needs grants	86,990	73,418
Total County and District Law Libraries expenses	7,387,545	7,140,431
Total expenses	7,796,557	7,553,736
Excess of revenue over expenses (expenses over revenues) for year	26,335	(312,996)

See accompanying notes

Statement of Changes in Fund Balances

*Stated in dollars**For the year ended December 31*

	2006				2005
	General Fund	Invested in Capital Assets Fund	Reserve Fund	Total	Total
Balances, beginning of year	430	11,324	1,070,662	1,082,416	1,395,412
Excess of revenue over expenses (expenses over revenue)	3,503	(3,427)	26,259	26,335	(312,996)
Balances, end of year	3,933	7,897	1,096,921	1,108,751	1,082,416

See accompanying notes

LIBRARYCO INC.

Statement of Cash Flows

*Stated in dollars**For the year ended December 31*

	2006	2005
OPERATING ACTIVITIES		
Excess of revenues over expenses (expenses over revenues)	26,335	(312,996)
Item not affecting cash		
Amortization of capital assets	3,427	5,190
Net change in non-cash operating working capital items		
Prepaid expenses	(680)	1,608
Goods and Services Tax receivable	(3,675)	12,468
Due from Law Foundation of Ontario	(39,677)	—
Accounts payable and accrued liabilities	(8,571)	30,144
Total operating activities	(22,841)	(263,586)
Decrease in cash	(22,841)	(263,586)
Cash and short-term investments, beginning of year	1,110,103	1,373,689
Cash and short-term investments, end of year	1,087,262	1,110,103

See accompanying notes

Notes to Financial Statements

Stated in whole dollars except where indicated

For the year ended December 31, 2006

1. General

LibraryCo Inc. (the "organization") was incorporated on April 12, 2001 under the Ontario Business Corporations Act as a not-for-profit organization. The Law Society of Upper Canada holds all common shares of the organization and the County and District Law Presidents' Association holds all special shares.

The purpose of the organization is to administer funding from the members of the Law Society of Upper Canada and develop policies, priorities, guidelines and standards for the delivery of county law library services across Ontario including the distribution of funds to the various County and District Law Libraries.

As a not-for-profit organization, LibraryCo Inc. is not subject to federal and provincial income and capital taxes.

2. Significant Accounting Policies

Basis of presentation

The financial statements have been prepared in accordance with the accounting standards for non-profit organizations published by the Canadian Institute of Chartered Accountants, using the restricted fund method of reporting contributions.

The General Fund accounts for the delivery, management and administration of library services. The Reserve Fund is restricted for specific purposes as periodically determined and approved by the Board of Directors. The Invested in Capital Assets Fund records the capital assets of the organization.

Cash and short-term investments

Cash and short-term investments are amounts on deposit and invested in short-term (less than one year) investment vehicles according to the organization's investment policy. Short-term investments are stated at the lower of cost and market value. Investment income, except income earned on General Fund resources, is retained in and reported by the Reserve Fund.

Capital assets

Capital assets are presented at cost net of accumulated amortization. Amortization is charged to expenses on a declining balance basis as follows:

Furniture and fixtures	20%
Computer equipment	30%
Leasehold improvements	Straight-line over term of lease

In the year of acquisition, half the normal amortization is provided. Computer software is expensed in the year of acquisition.

LIBRARYCO INC.

Revenue recognition

Restricted contributions related to the general operations are recognized as revenue of the General Fund in the year in which the related expenses are incurred. All other restricted contributions are recognized as revenue of the appropriate restricted fund.

Collections

The organization owns a collection of traditional, and electronic based, legal research and reference material. The cost of additions to the collection is expensed as incurred.

Financial instruments

The estimated fair value of cash and short-term investments, accounts receivable, prepaid expenses, accounts payable and accrued liabilities approximate their carrying amounts in the financial statements due to the relatively short period to maturity of these instruments.

Measurement uncertainty

The preparation of the financial statements in accordance with Canadian Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingencies at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Capital Assets

	2006			2005
	Cost	Accumulated amortization	Net	Net
Furniture and fixtures	\$16,563	\$11,796	\$ 4,767	\$ 5,959
Computer equipment	20,630	17,500	3,130	4,472
Leasehold improvements	8,927	8,927	–	893
	\$ 46,120	\$38,223	\$ 7,897	\$11,324

LIBRARYCO INC.

4. Share Capital

Authorized

Unlimited number of Common shares

Unlimited number of Special shares, with right to elect one director

Issued	2006	2005
100 Common shares	\$100	\$100
100 Special shares	100	100
	\$200	\$200

At incorporation, the organization issued 100 Common shares to the Law Society of Upper Canada and 100 Special shares to the County & District Law Presidents' Association for cash consideration of \$100 each.

5. Other Expenses – Head Office/Administration

Included in this expense are costs associated with bank charges, directors and officers insurance, Board of Directors' meetings and other miscellaneous items.

6. Other Expenses – County and District Law Libraries – centralized purchases

Included in this expense are costs associated with staff travel, document delivery, publications, cataloguing, committee meetings, and miscellaneous items.

7. County and District Law Library Grants

These grants represent the quarterly distribution of funds to the 48 County and District Law Libraries. They are distributed in accordance with policies and procedures as established by the organization's Board of Directors.

In order to satisfy themselves as to the proper use of these funds, management has undertaken the following procedures:

Periodic visits, by the organization's staff, to the individual libraries to review financial information, assess collections, and to determine services being provided;

Submission of annual budgets by each individual library and review of these budgets by the organization's staff;

Submission of periodic financial information by each individual library and review of this information by the organization's staff; and

Annual conference with the organization's staff and staff of all individual libraries.

LIBRARYCO INC.

The following individual library grants were distributed by the organization during 2006 and 2005:

	2006	2005
Algoma District Law Association	\$ 110,625	\$ 109,414
Brant Law Association	71,106	70,168
Bruce Law Association	44,581	52,246
County of Carleton Law Association	542,559	534,270
Cochrane Law Association	35,017	40,709
Dufferin Law Association	45,775	45,277
Durham County Law Association	110,508	109,441
Elgin Law Association	54,730	62,122
Essex Law Association	228,637	225,125
Frontenac Law Association	124,565	122,542
Grey Law Association	46,575	54,182
Haldimand Law Association	23,999	24,253
Halton Law Association	103,792	107,790
Hamilton Law Association	358,142	352,527
Hastings Law Association	62,538	69,735
Huron Law Association	53,788	61,179
Kenora Law Association	72,773	71,899
Kent Law Association	50,840	58,323
Lambton County Law Association	43,902	52,049
County of Lanark Law Association	21,478	21,746
Leeds & Grenville Law Association	56,304	55,807
Lennox & Addington Law Association	22,581	22,815
Lincoln Law Association	139,182	137,119
Manitoulin Law Association	6,180	6,180
Middlesex Law Association	286,590	282,385
Muskoka Law Association	34,156	40,796
Nipissing Law Association	61,810	66,736
Norfolk Law Association	58,649	57,761
Northumberland County Law Association	58,453	57,839
Oxford Law Association	59,653	61,020
Parry Sound Law Association	24,987	25,205
Peel Law Association	237,675	198,691
County of Perth Law Association	46,131	53,687
Peterborough Law Association	86,512	91,259
Prescott & Russell Law Association	9,462	4,983
Rainy River Law Association	22,992	23,216
Renfrew County Law Association	96,758	96,375
County of Simcoe Law Association	115,922	115,009
Stormont, Dundas & Glengarry Law Association	54,179	61,725
Sudbury District Law Association	138,409	128,264
Temiskaming Law Association	35,271	41,843
Thunder Bay Law Association	131,821	130,037
Toronto Lawyers Association	493,184	486,301
Victoria Haliburton Law Association	69,400	68,522
Waterloo Law Association	199,397	196,682
Welland Law Association	74,662	73,451
Wellington Law Association	63,684	63,114
York Region Law Association	170,584	168,268
	\$5,060,518	\$5,060,087

LIBRARYCO INC.

8. Related Party Transactions

	2006	2005
Purchases from the Law Society of Upper Canada	\$ 82,424	\$ 94,254

Included in purchases from the Law Society of Upper Canada are costs associated with cataloguing of collections, CLE and Licensing Process materials for the County & District Law Libraries, other publications and catering for Board of Directors' meetings.

Included in the December 31, 2006 balance for accounts payables and accrued liabilities are amounts due to the Law Society of Upper Canada totalling \$3,115 (2005 – \$Nil).

9. Lease Commitments

The organization has entered into a lease arrangement for its offices. The lease expires July 31, 2007 and requires annual payments of \$13,200 plus operating costs.

10. Contingencies and Guarantees

In the normal course of business, the organization enters into agreements that meet the definition of a guarantee. The organization's primary guarantees are as follows:

(a) Indemnity has been provided to all directors and/or officers of the organization for various items including, but not limited to, all costs to settle suits or actions due to their involvement with the organization, subject to certain restrictions. The organization has purchased directors' and officers' liability insurance to mitigate the cost of any potential future suits or actions. The term of the indemnification is not explicitly defined, but is limited to the period over which the indemnified party served as a trustee, director or officer of the organization. The maximum amount of any potential future payment cannot be reasonably estimated.

(b) In the normal course of business, the organization has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, engagement letters with advisors and consultants, leasing contracts, information technology agreements and service agreements. These indemnification agreements may require the organization to compensate counterparties for losses incurred by the counterparties as a result of breaches in representation and regulations or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnities are not explicitly defined and the maximum amount of any potential reimbursement cannot be reasonably estimated.

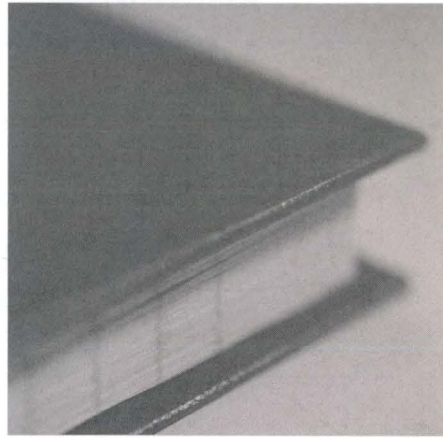
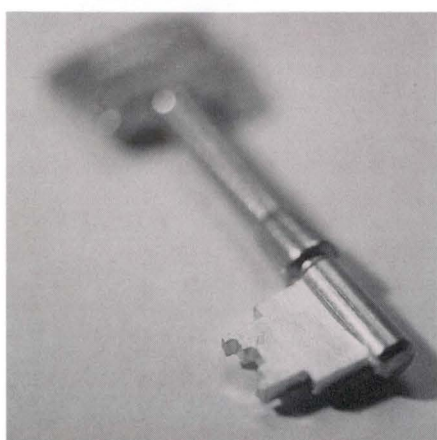
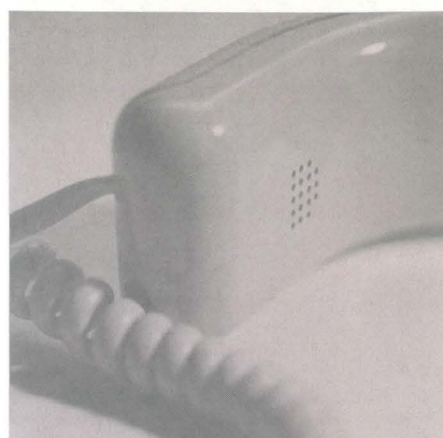
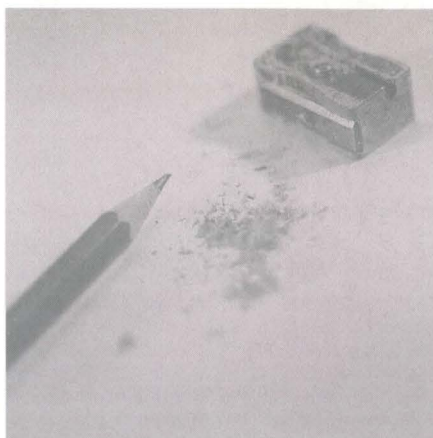
The nature of these indemnification agreements prevents the organization from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the amount of liability that stems from the unpredictability of future events and the unlimited coverage offered to counterparties. Historically, the organization has not made

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any significant payments under such or similar indemnification agreements and therefore no amount has been accrued in the financial statements with respect to these agreements.

11. Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform to the current year's financial statement presentation.



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